

**Baker & Hostetler LLP**

45 Rockefeller Plaza  
New York, New York 10111  
Telephone: (212) 589-4200  
Facsimile: (212) 589-4201  
David J. Sheehan  
Nicholas J. Cremona  
Jorian L. Rose  
Amy E. Vanderwal  
Jason I. Blanchard

Hearing Date: June 16, 2021  
Hearing Time: 10:00 a.m. (EST)  
Objections Due: June 4, 2021  
Objection Time: 4:00 p.m. (EST)

*Attorneys for Irving H. Picard, Trustee  
for the Substantively Consolidated SIPA Liquidation  
of Bernard L. Madoff Investment Securities LLC  
and the chapter 7 estate of Bernard L. Madoff*

**UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF NEW YORK**

SECURITIES INVESTOR PROTECTION  
CORPORATION,

Plaintiff-Applicant,

v.

BERNARD L. MADOFF INVESTMENT  
SECURITIES LLC,

Defendant.

In re:

BERNARD L. MADOFF,

Debtor.

Adv. Pro. No. 08-01789 (CGM)

SIPA LIQUIDATION

(Substantively Consolidated)

**TRUSTEE'S FORTIETH OMNIBUS MOTION TO DISALLOW CLAIMS AND  
OVERRULE OBJECTIONS OF CLAIMANTS WHO HAVE NO NET EQUITY**

Irving H. Picard, trustee (“Trustee”) for the substantively consolidated liquidation of Bernard L. Madoff Investment Securities LLC (“BLMIS”) under the Securities Investor Protection Act, 15 U.S.C. §§ 78aaa–III, (“SIPA”),<sup>1</sup> and the chapter 7 estate of Bernard L. Madoff (“Madoff”) (collectively, the “Debtor”), by this combined motion and memorandum of law (the “Motion”), asks this Court to overrule objections to his claims determinations (the “Objections”) and affirm his denial of certain customer claims (the “Claims”) filed by customers that withdrew more money from BLMIS than they deposited and are thus, in the parlance of this case, net winners (collectively, the “Claimants”). The nine Claims and five related Objections at issue in this Motion are listed in alphabetical order by the Claimant’s first name on Exhibit A to Vineet Sehgal’s Declaration in Support of the Motion (the “Sehgal Declaration”).

### **PRELIMINARY STATEMENT**

The Trustee determined the Claims by applying one or more of the methodologies for calculating net equity that have been approved by the courts during this SIPA liquidation. In the Objections, the Claimants contest the Trustee’s claims determinations on various legal grounds that have been uniformly rejected by the courts and resolved in the Trustee’s favor. Specifically, the Claimants make one or more of the following arguments: (i) the Trustee improperly determined net equity based on the cash in/cash out method (the “Net Investment Method”); (ii) the Trustee improperly determined the net equity of accounts that received one or more transfers from another BLMIS account (the “Inter-Account Method”); (iii) the Trustee should have made adjustments to net equity to account for the length of time Claimants were invested with BLMIS (the “Time-Based Damages Adjustment”); (iv) the Trustee should have made adjustments to net

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<sup>1</sup> Subsequent references to SIPA shall omit “15 U.S.C.”

equity to account for payments Claimants made in compliance with the Internal Revenue Code (the “Tax-Based Adjustment”); and (v) the Trustee incorrectly treated profit withdrawal transactions (“PW Transactions”) reflected on the Claimants’ customer statements as debits for the purpose of determining net equity.

The courts have approved the Trustee’s use of the Net Investment Method, his rejection of a Time-Based Damages Adjustment, and the United States Supreme Court has declined to address these issues. In addition, the Second Circuit has validated the Inter-Account Method and recently affirmed the Trustee’s treatment of PW Transactions as withdrawals. Those decisions are final and no longer subject to appeal. The courts have likewise rejected arguments for a Tax-Based Adjustment. Thus, the Claimants are not entitled to an adjustment to their net equity on any of these grounds.

Since his appointment, the Trustee and his professionals have continued to evaluate claims against BLMIS and objections to the Trustee’s claims determinations. In doing so, the Trustee evaluates whether particular claims and objections are ripe for final adjudication and whether any pending avoidance actions relate to those claimants. Here, the Trustee submits that the Claims and Objections are ripe for final adjudication. All the legal arguments raised in the Objections have been finally decided and there are no pending avoidance actions related to the Claimants. Therefore, the Trustee respectfully requests that the Court overrule the Objections and affirm his determinations of the Claims.

### **JURISDICTION**

This Court has jurisdiction to consider this matter pursuant to SIPA §§ 78eee(b)(2) and 78eee(b)(4) and 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b).

## **BACKGROUND**

### **1. The Commencement of the SIPA Proceeding**

The basic facts of the BLMIS fraud are widely known and have been recounted in numerous decisions. *See, e.g., In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d 229, 231 (2d Cir. 2011); *In re Beacon Assocs. Litig.*, 745 F. Supp. 2d 386, 393–94 (S.D.N.Y. 2010). On December 11, 2008, the Securities and Exchange Commission (“SEC”) filed a complaint in the District Court against Madoff and BLMIS, captioned *SEC v. Madoff*, No. 1:08-cv-10791-LLS, 2008 WL 5197070 (S.D.N.Y. Dec. 11, 2008), alleging fraud through the investment advisor activities of BLMIS. The SEC consented to the consolidation of its case with an application of the Securities Investor Protection Corporation (“SIPC”). Thereafter, SIPC filed an application under SIPA § 78eee(a)(4) alleging that because of BLMIS’s insolvency, its customers needed SIPA protection. The District Court appointed the Trustee under SIPA § 78eee(b)(3) and removed the proceeding to this Court under SIPA § 78eee(b)(4).

### **2. The Trustee’s Role under SIPA**

Under SIPA, the Trustee is responsible for, among other things, recovering and distributing customer property to a broker’s customers, assessing claims, and liquidating other assets of the firm for the benefit of the estate and its creditors. A SIPA trustee has the general powers of a bankruptcy trustee in addition to the powers granted by SIPA. SIPA § 78fff-1(a). In satisfying customer claims, the Trustee evaluates whether claimants are “customers,” as defined in SIPA § 78lll(2), who are entitled to share pro rata in “customer property,” defined in SIPA § 78lll(4), to the extent of their “net equity,” defined in SIPA § 78lll(11). For each customer with a valid net equity claim, SIPC advances funds to the SIPA trustee up to the amount of the customer’s net equity, not to exceed \$500,000 (the amount applicable to this case), if the

customer's share of customer property does not make her whole. SIPA § 78fff-3(a).

It is the customer's burden to demonstrate entitlement to customer status. *In re Bernard L. Madoff Inv. Sec. LLC*, 570 B.R. 477, 481 (Bankr. S.D.N.Y. 2017) (citing *Mishkin v. Siclari (In re Adler, Coleman Clearing Corp.)*, 277 B.R. 520, 557 (Bankr. S.D.N.Y. 2002) (“[I]t is well-established in the Second Circuit that a claimant bears the burden of proving that he or she is a ‘customer’ under SIPA.”)). The customer also bears the burden of proving the amount of his or her claim. *In re Bernard L. Madoff Inv. Sec. LLC*, 592 B.R. 513, 532 (Bankr. S.D.N.Y. 2018) (citing *Pitheckoff v. Sec. Inv'r Prot. Corp. (In re Great E. Sec., Inc.)*, No. 10 Civ. 8647 (CM), 2011 WL 1345152, at \*4 (S.D.N.Y. Apr. 5, 2011)) *aff'd* 605 B.R. 570 (S.D.N.Y. 2019), *aff'd* 830 F. App'x 669 (2d Cir. 2020).

### **3. The Claims Process in the BLMIS Liquidation**

On December 23, 2008, this Court entered a claims procedures order (the “Claims Procedure Order”), which approved (i) the form and manner of publication of the notice of the commencement of the liquidation proceeding and (ii) specified the procedures for filing, determining and adjudicating customer claims. (*See* ECF No. 12). BLMIS customers were directed to file their claims with the Trustee no later than six (6) months from the date the Trustee published notice of the commencement of the liquidation proceeding. *See* SIPA § 78fff-2(a)(3). After receiving a claim, the Trustee issued a determination letter to the claimant regarding the allowed amount of net equity. Claimants were permitted to object to the Trustee's determination of a claim by filing an objection in this Court, following which the Trustee requested a hearing date for the objection and notified the objecting claimant thereof.

Under the provisions of the Claims Procedure Order, the Trustee has successfully prosecuted numerous omnibus motions to affirm his claims determinations and overrule related

objections based on legal issues previously decided in his favor and many other motions to affirm his determinations that certain claimants should not be treated as “customers” under SIPA.

The Trustee has filed this Motion in accordance with the Claims Procedures Order to affirm his determinations of the Claims and overrule the Objections, which raise one or more of the legal issues identified below. The Claims and Objections are now ripe for final adjudication and there are no pending avoidance actions related to the Claimants.

### **RELIEF REQUESTED**

By this Motion, the Trustee seeks the entry of an order affirming the Trustee’s determination of the Claims in accordance with the Net Investment and Inter-Account Methods, and without a Time-Based Damages Adjustment or Tax-Based Adjustment. The Trustee further seeks approval of his treatment of the PW Transactions reflected on the Claimants’ customer statements as debits for the purpose of determining the Claimants’ net equity. The Trustee respectfully requests that Court disallow the Claims of the Claimants, affirm the Trustee’s claims determinations of the Claims, and overrule the Objections.

### **BASIS FOR RELIEF**

#### **1. The Net Investment Method**

Pursuant to SIPA § 78fff(11), the term “net equity” means the:

dollar amount of the account or accounts of a customer, to be determined by – (A) calculating the sum which would have been owed by the debtor to such customer if the debtor had liquidated, by sale or purchase on the filing date, all securities positions of such customer (other than customer name securities reclaimed by such customer); . . . minus (B) any indebtedness of such customer to the debtor on the filing date.

SIPA § 78fff-2(b) directs the Trustee to make payments to customers based on “net equity” insofar as the amount owed to the customer is “ascertainable from the books and records of the debtor or [is] otherwise established to the satisfaction of the trustee.”

On this basis, the Trustee determined that net equity claims should be calculated according to the Net Investment Method. The Trustee calculated the amounts of money that customers deposited into their BLMIS accounts and subtracted any amounts they withdrew from their BLMIS accounts. Some claimants argued that the Trustee was instead required to calculate net equity using the amounts shown on their November 30, 2008 customer statements (the “Last Customer Statement Method”).

This Court rejected the Last Customer Statement Method and upheld the Trustee’s use of the Net Investment Method. *In re Bernard L. Madoff Inv. Sec. LLC*, 424 B.R. 122, 134-35 (Bankr. S.D.N.Y. 2010). Pursuant to 28 U.S.C. § 158(d)(2), the Bankruptcy Court certified an immediate appeal of its decision, which the United States Court of Appeals for the Second Circuit granted. *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d 229, 234 (2d Cir. 2011). The Second Circuit subsequently affirmed the Bankruptcy Court’s decision. *Id.* at 235-36. Then, on June 25, 2012, the United States Supreme Court denied certiorari. *Velvet v. Picard*, 133 S. Ct. 25 (2012); *Ryan v. Picard*, 133 S. Ct. 24 (2012). Therefore, a final order upholding the Trustee’s use of the Net Investment Method has been issued.

## **2. The Inter-Account Method**

An inter-account transfer is a transfer between BLMIS customer accounts in which no new funds entered or left BLMIS. BLMIS recorded a book entry to internally adjust the balances of those accounts, but because there was no actual movement of cash, these book entries did not reflect any transfers of cash. Rather, the inter-account transfers merely changed the reported value of the purported equity maintained in the accounts. Such transfers consisted of the following: (i) all principal; (ii) all fictitious profits; or (iii) a combination of principal and fictitious profits.

To calculate the net equity for accounts with inter-account transfers, the Trustee calculated the actual amount of principal available in the transferor account at the time of the transfer and credited the transferee account up to that same amount. Consistent with the Net Investment Method, the Trustee did not include any fictitious gains in the net equity calculation. If the transferor account did not have any principal available at the time of the inter-account transfer, the transferee account was credited with \$0 for that transfer. Similarly, if the transferor account had principal available at the time of the inter-account transfer, the transferee account was credited with the amount of the inter-account transfer, to the extent of that principal.

Several claimants argued that the Trustee was instead required to credit inter-account transfers at their full, face value, as if actual money had been moved from one BLMIS account to another. In other words, these claimants argued that the Trustee should treat inter-account transfers as if they were external cash withdrawals by the transferor and external cash deposits by the transferee.

This Court approved the Trustee's use of the Inter-Account Method and held that "increasing [Claimants'] net equity claims by giving them credit for the fictitious profits 'transferred' into their accounts contravenes the *Net Equity Decision*." *Sec. Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (In re Bernard L. Madoff)*, 522 B.R. 41, 47 (Bankr. S.D.N.Y. 2014). The Court explained:

[l]ike the Net Investment Method on which it is based [the Inter-Account Method] . . . ignores the imaginary, fictitious profits . . . and conserves the limited customer pool available to pay net equity claims on an equitable basis. . . . Crediting the Objecting Claimants with the fictitious profits . . . essentially applies the Last Statement Method to the transferors' accounts, and suffers from the same shortcomings noted in the *Net Equity Decision*. It turns Madoff's fiction into a fact.

*Id.* at 53. Several claimants appealed and on January 14, 2016, the District Court issued its



Opinion and Order affirming this Court's decision. The District Court held that the Inter-Account Method "is the only method of calculating net equity in the context of inter-account transfers that is consistent with the Second Circuit's *Net Equity Decision*, and that it is not prohibited by law." *In re Bernard L. Madoff Inv. Secs., LLC*, No. 15 Civ. 1151 (PAE), 2016 WL 183492, at \*2 (S.D.N.Y. Jan. 14, 2016). Several claimants further appealed to the Second Circuit. The Second Circuit affirmed the District Court's decision, *Sagor v. Picard (In re Bernard L. Madoff Inv. Sec. LLC)*, 697 F. App'x 708 (2d Cir. 2017), and no appeal was taken. Accordingly, the Second Circuit's decision stands as final.

### **3. Time-Based Damages Adjustment**

Certain Claimants filed Objections seeking to adjust the Trustee's net equity calculation to allow for a Time-Based Damages Adjustment. Following the United States Supreme Court's decision denying certiorari on the Net Investment Method, the Trustee filed a motion to address objections that sought a Time-Based Damages Adjustment, arguing it is inconsistent with SIPA and therefore cannot be awarded. (*See* ECF No. 5038). In response, claimants raised numerous theories, all of which sought some increase in their customer claims based upon the amount of time they had invested with BLMIS. Most commonly, claimants relied on the New York prejudgment rate of 9% per annum, lost opportunity cost damages, or the consumer price index to take inflation into account.

The Bankruptcy Court ruled that, as a matter of law, SIPA does not permit the addition of time-based damages to net equity, and therefore upheld the Trustee's rejection of a Time-Based Damages Adjustment. *Sec. Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 496 B.R. 744, 754-55 (Bankr. S.D.N.Y. 2013). Following its decision, the Bankruptcy Court certified an immediate appeal pursuant to 28 U.S.C. § 158(d)(2), which the Second Circuit granted. *In re*

*Bernard L. Madoff Inv. Sec. LLC*, 779 F.3d 74, 78-79 (2d Cir. 2015). The Second Circuit affirmed the Bankruptcy Court’s decision, holding that SIPA did not permit a Time-Based Damages Adjustment to “net equity” claims for customer property. *Id.* at 83. The Second Circuit concluded that such an adjustment would have gone beyond the scope of SIPA’s intended protections and was inconsistent with SIPA’s statutory framework. *Id.* at 79.

On October 5, 2015, the United States Supreme Court denied certiorari, and thus a final order has been issued upholding the Trustee’s rejection of a Time-Based Damages Adjustment. *Peshkin v. Picard*, 136 S. Ct. 218 (2015).

#### **4. Tax-Based Adjustment**

Certain Claimants filed Objections seeking to adjust the Trustee’s net equity calculation to allow for a Tax-Based Adjustment. Specifically, these Claimants argue that the Trustee should give them credit for payments they made to the Internal Revenue Service (“IRS”) required under the Internal Revenue Code or credit for mandatory withdrawals they received in connection with their individual retirement accounts.

The Trustee has not provided any claimants with “credit” for payments of taxes to the IRS in connection with withdrawals from their BLMIS accounts, nor has the Trustee provided claimants with “credit” for mandatory withdrawals from their individual retirement accounts. To do so would be inconsistent with SIPA and the decisions affirming the Trustee’s application of the Net Investment Method and rejection of a Time-Based Damages Adjustment. Nor have Claimants cited to any authority supporting such “credit.” The Trustee’s ability to “claw back” or avoid transfers does not affect the net equity analysis, especially where Claimants subject to this Motion are not the subject of avoidance actions by the Trustee.

In the inter-account transfer decision, this Court rejected the argument that net equity should take into consideration the taxes paid by the customer. *Bernard L. Madoff Inv. Sec. LLC*, 522 B.R. at 54 n.9 (citing *Donell v. Kowell*, 533 F.3d 762, 778–79 (9th Cir. 2008), *cert. denied*, 555 U.S. 1047, 129 S. Ct. 640, 172 L. Ed. 2d 612 (2008)); *see also Sec. Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, No. 08-1789 (SMB), 2020 WL 3264056, at \*2 (Bankr. S.D.N.Y. June 10, 2020) (stating the same). Similarly, this Court has determined that the Trustee can avoid BLMIS customers' mandatory withdrawals from their individual retirement accounts as fraudulent transfers. *Sec. Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 476 B.R. 715, 729 (S.D.N.Y. 2012), supplemented (May 15, 2012), *aff'd sub nom. In re Bernard L. Madoff Inv. Sec. LLC*, 773 F.3d 411 (2d Cir. 2014); *cf. Picard v. Nelson (In re Bernard L. Madoff Inv. Sec. LLC)*, 610 B.R. 197, 236-37 (Bankr. S.D.N.Y. 2019) (a defendant who withdrew fictitious profits from a Ponzi scheme may not offset fraudulent transfer liability with the taxes paid on account of those fictitious gains) (citing precedent). Therefore, the Trustee's determination that the Claimants are not entitled to a Tax-Based Adjustment to their Claims should be upheld.

## **5. Profit Withdrawal Transactions**

BLMIS fabricated stock transactions based on historical trading data to give the appearance of profitable trading activity. BLMIS employees would set up fictional "deals" in a particular stock and record the ostensible purchase of that stock on customer statements as a debit. At the conclusion of the deal period, the customer statements would show a purported sale of the stock and a corresponding credit for the sale price. The difference between the sale and purchase price for the deal stock would invariably show a "profit" for the associated BLMIS account.

Upon opening an account with BLMIS, certain customers would elect to have such “profits” sent to them at the conclusion of each deal. For customers that elected to be sent profits, BLMIS automatically sent a check in the amount of the fictitious profits. Profit withdrawals refer to these distributions of fictitious profits that BLMIS sent to its customers for the returns purportedly generated in their customer accounts as a result of fictitious trading activity. The underlying PW Transactions were recorded on the BLMIS customers’ monthly statements with a “PW” notation followed by the name of a publicly-traded corporation and a corresponding deduction from the account holders’ equity balance.

Certain claimants objected to the Trustee’s treatment of PW Transactions as cash withdrawals. Given the number of claimants whose accounts contain PW Transactions, Judge Bernstein established an omnibus proceeding to give all affected claimants the opportunity to brief the issue and conduct discovery (*See* ECF No. 10266) and conducted a trial of the objection of Aaron Blecker to the Trustee’s determination of his claims. The claimants who chose to participate in the omnibus proceeding argued, among other things, that in the absence of any corroborating evidence by the Trustee, PW Transactions should be disregarded and net equity increased accordingly.

Following an evidentiary hearing, the Bankruptcy Court concluded that “PW Transactions listed in a customer’s monthly statement supports the finding, absent credible contrary evidence, that a check in that amount was sent to the customer and constitutes a cash withdrawal under the Net Investment Method.” *Bernard L. Madoff Inv. Sec. LLC*, 592 B.R. at 538. Based on the trial evidence, the Court found that Mr. Blecker had ratified BLMIS’s treatment of the PW Transactions as debits to his accounts and had failed to sustain his burden in

proving that his customer accounts had positive net equity. *Id.* at 531-32.<sup>2</sup> On appeal, the District Court affirmed the Bankruptcy Court's decision in all respects. *See Blecker v. Picard (In re Bernard L. Madoff Inv. Sec. LLC)*, 605 B.R. 570 (S.D.N.Y. 2019). The Second Circuit also affirmed, *Blecker v. Picard (In re Bernard L. Madoff Inv. Sec. LLC)*, 830 F. App'x 669 (2d Cir. 2020), and no further appeal was taken, rendering the Second Circuit's decision final.<sup>3</sup>

### **NOTICE**

Notice of this Motion has been provided by U.S. mail, postage prepaid, or email to the following: (i) all Claimants listed on Exhibit A to the Sehgal Declaration (and their counsel) whose Objections are subject to this Motion; (ii) all parties included in the Master Service List as defined in the Order Establishing Notice Procedures (ECF No. 4560); (iii) all parties that have filed a notice of appearance in this case; (iv) the SEC; (v) the IRS; (vi) the United States Attorney for the Southern District of New York; and (vii) SIPC, pursuant to the Order Establishing Notice Procedures (ECF No. 4560). The Trustee submits that no other or further notice is required. In addition, the Motion and related pleadings will be posted to the Trustee's website [www.madofftrustee.com](http://www.madofftrustee.com) and are accessible, without charge, from that site.

No previous request for the relief sought herein has been made by the Trustee to this or any other Court.

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<sup>2</sup> The Court also determined that Mr. Blecker ratified the PW Transactions because he failed to object to the PW Transactions depicted on his monthly customer statements.

<sup>3</sup> The deadline to file a petition for writ of certiorari has expired. *See* 28 U.S.C. §§ 1254, 2101(c).

**CONCLUSION**

For the reasons stated, the Trustee respectfully requests that the Court enter an order (i) disallowing the Claims of the net winner Claimants, (ii) affirming the Trustee's claims determinations of the Claims, (iii) overruling the Objections, and (iv) granting such other and further relief as is just.

Dated: New York, New York  
May 7, 2021

Respectfully submitted,

/s/ David J. Sheehan

**Baker & Hostetler LLP**

45 Rockefeller Plaza

New York, New York 10111

Tel: (212) 589-4200

Fax: (212) 589-4201

David J. Sheehan

Email: dsheehan@bakerlaw.com

Nicholas J. Cremona

Email: ncremona@bakerlaw.com

Jorian L. Rose

Email: jrose@bakerlaw.com

Amy E. Vanderwal

Email: avanderwal@bakerlaw.com

Jason I. Blanchard

Email: jblanchard@bakerlaw.com

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